



Veles International

VELES INTERNATIONAL LIMITED

Pillar 3 disclosures for the year ended 31 December 2008

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1. Introduction

Veles International Limited ('the Company') is regulated by the Cyprus Securities and Exchange Commission ('CySEC') under authorization number CIF075/06 issued on 20 September 2006 by which it is licensed to operate as a Cypriot Investment Firm and to provide the investment and non-core services in relation to the transferable securities and shares in collective investments undertakings. The principal activities of the Company are the provision of investment services (receipt, transmission and execution of client orders), safe custody services and dealing in securities for own account in accordance with the provisions of the applicable legislation and requirements issued by the Cyprus Securities and Exchange Commission.

This report has been prepared in accordance with the requirements of the Directive DI144-2007-05 for the Capital Requirements of Investment Firms ('the Directive') issued by the Cyprus Securities and Exchange Commission. The Directive implements the European Union's Capital Requirements Directive ('CRD').

The Directive describes the Basel II framework which is based on three pillars:

- Pillar 1 has to do with the standards that set out the minimum regulatory capital requirements that are required for credit, market and operational risk
- Pillar 2 covers the Supervisory Review Process which assesses the internal capital adequacy processes. Investment firms and Supervisors have to evaluate and assess whether an Investment Firm should hold additional capital against risks not covered in Pillar 1
- Pillar 3 (Market discipline) covers transparency and the obligation of Investment Firms to disclose meaningful information to the market related to their risks, capital and generally risk management.

The Company's Pillar 3 disclosures below have been prepared using 31 December 2008 data in accordance with the Directive.

The requirements of the Directive apply to the Company on an individual basis.

2. Risk Management Objectives and Policies

2.1. Risk Management Organisation

Risk is inherent to the Company's business and activities. The Company's ability to identify, measure, monitor and manage each type of risk to which the Company is exposed is an important factor in its financial stability, performance, reputation and in the achievement of its strategic objectives.

Risk Management Framework

This framework provides a comprehensive approach for the Company for identifying, measuring, monitoring and managing each type of risk to which the Company is exposed. By adopting a formal approach to risk management we achieve better outcomes as a result of systematically identifying and analysing the wide range of issues that affect decision-making.

The risk management framework has been developed to:

- ensure that the primary objective of the risk management process is achieved. This is to ensure that a level of capital adequacy is maintained so that the total risk taken by the Company is no greater than the Company's ability to absorb losses

- allow the Company to proactively manage its risks in a systematic and structured way and to continually refine its processes to reduce its risk profile and ultimately its capital requirements
- ensure appropriate strategies are in place to mitigate or transfer risks
- embed the risk management process and ensure it is an integral part of the Company's process of strategic decision making and capital planning
- help create a risk awareness culture at all departments within the Company
- engage the Company's management's attention to the management, monitoring, reporting and reviewing of identified risks as well as considering new and emerging risks on a continuous basis.

Risk Management Process

The risk management process is integrated within the organisation through established internal policies, systems, controls and comprehensive reporting, commensurate with the complexity of the Company's activities and structure. The system of internal controls provides reasonable assurance for the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with applicable laws and regulations. The risk management process provides for the continuous monitoring of the system of internal controls to ensure its effectiveness.

The Risk Management Department is responsible for determination, evaluation and efficient management of the risks inherent in the provision of the investment services. The department's aim is to provide these services in accordance with the provisions of the Investment Services, Activities and Regulated Markets Law of 2007 (Law 144(I)/2007) and Directives issued by the CySEC, as well as the internal regulations of the Company.

The Risk Management Department of the Company has the following duties and responsibilities:

- Development of policy regarding the assumption, follow up and management of risk which will include guidelines regarding possible risk exposure and acceptable risk levels
- Development of risk management policy for clients and counterparties for the following risks:
 - credit risk
 - liquidity risk
 - market risk
- Analysis for the Investment Committee the potential hazards associated with the recommended framework on which investment decisions/advice are based.
- Credit assessment (including quality and financial analysis) of clients when opening a new client account and classification of clients according to the Company's risk criteria and limits
- Credit assessment of counterparties and classification of the counterparty according to company's risk criteria and limits
- Monitoring of investment risk undertaken by the company for each client, counterparty and for the Company as a whole
- Estimating risk of the Company's clients and counterparties participation in money laundering and/or terrorist funding
- Monitoring of deals executed with counterparties in relation with securities' market prices

- Monitoring of brokerage and asset management transactions as regards adherence to established risk limits
- Monitoring risk associated with margin trading clients
- Monitoring day-to-day operational risks
- Building a risk aware culture within the organisation and providing the relevant training
- Maintenance of appropriate internal control systems designed to manage key risk areas
- Evaluation of risks associated with the development of new investment products
- Providing an annual written report to the Company's Board of Directors on the matters of the Department's responsibilities indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies.

The Group's strategies and processes for managing risks, as well as the measurement systems used and the hedging and mitigating strategies are analysed below by risk division.

2.2. Credit Risk Management

Credit risk is defined as the potential that a company borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximize a company's risk-adjusted rate of return in the provision of the investment services by maintaining credit risk exposure within acceptable parameters. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of an investment company.

Measurement and Assessment

The Credit Risk Management Policy establishes the framework for credit assessment, structure of limits and process of approval and monitoring of credit risks. Company manages the credit risk inherent in the entire portfolio as well as the risk attributable to individual credits or transactions. Credit exposures from related accounts are aggregated and monitored on a consolidated basis.

The Company's Risk Manager sets targets and limits for the composition and quality of the loans, advances and trade debtors portfolio and monitors compliance with them. Limits approval is done by the Investment Committee of the Company on the basis of List of limits prepared by the Company's Risk Manager.

Creditworthiness Assessment of Clients and Counterparties

Evaluation of client or counterparty creditworthiness involves analysis of financial and non-financial data, including submitted pledge to cover their credit risks.

Financial data includes:

- balance sheet,
- income statement,
- diversification,
- leverage and other information from financial statements.

Non-financial data are includes:

- Qualitative characteristics (such as industry review, business risk, etc)
- Reputation
- Assessment of credit risk by external assessors

All required information is collected from the clients during account opening KYC procedures and from the counterparties during due diligence procedures.

The assessment of the quality of the portfolio is carried out using credit rating and credit scoring systems to determine the creditworthiness of customers. Credit Rating approach to credit risk classifies companies based on their rating with External Credit Assessment Institutions (ECAI) and calculates the historical percentage of defaults for each rating. The Company only uses ECAIs that have been recognized and announced as eligible by CySEC. The calculation of the overall credit risk is also performed using the SAS Credit Risk Management that gives the possibility to quickly and accurately calculate critical risk measures, such as probability of default, exposure at default, credit migration, regulatory capital, risk weighted assets, credit value at risk (CVaR) and economic capital. The system also allows performing mark-to-market calculations, model risk factors, running Monte Carlo simulations, exploring scenarios and building stress tests. Every step of the process can be viewed, validated, audited and customized.

Efficient Monitoring and Control

Company's Risk Manager constantly reviews clients and counterparties creditability. Monitoring includes review of the following data:

- previously collected information
- limits set previously for this client or counterparty
- all financial data information updates collected from the last review (not less than one year)
- all non-financial information (not less than six months)

Purpose of such monitoring is to ensure that limits set previously to clients and counterparties are valid and there is no negative information stipulating high probability of counterpart's / client's failure to carry their obligations. Following the review, Risk Management amends if required the limits set previously for this particular client or counterparty.

Approved credit limits are registered on a protected excel spreadsheet and circulated to all traders and front office and back office employees as an extra monitoring tool. In cases where a trader enters a deal which results in violation of credit limits, the deal is blocked by the system (ORC-software) and is not executed. The Risk Management department is informed of any violations and makes decision whether to accept the violation or close the deal.

2.3. Market Risk Management

Market risk reflects the extent to which the return of the security varies in response to, or in association with, variations in the overall market returns. Market risk is associated with the Company's open positions, which are exposed to the risks of changes in the market. Credit, country, liquidity, exchange rate and interest rate risks in particular have an impact in the form of price fluctuations.

The Company's Risk Management Department is responsible for measuring and monitoring of these risks and setting out the policy for management of market risk and approving acceptable market risk limits, such as position limits, stop-loss limits etc. The evaluation of market risk of certain instruments and the total risk are carried out on a daily basis using the Value at Risk (VaR) approach. The Risk Management Department prepares reports on the methods used by the Company for the estimation and valuation of the market risk for the ratification by the Board of Directors of the Company.

The lack of sophistication in monitoring of emerging financial markets can result in poor levels of market transparency, liquidity, efficiency and regulation in the emerging markets. Moreover, high volatility and large price differences are characteristic of these markets. Finally, the inadequacy or absence of regulatory measures gives rise to an increased danger of market manipulation or insider trading.

2.4. Operational Risk Management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk but excludes reputation and strategic risks. It is embedded in every business activity and potential losses may occur in all the Company's activities.

The Company has adopted the Basic Indicator Approach for the assessment of own funds requirements for operational risk. The capital requirement for operational risk under the Basic Indicator Approach is equal to 15% of a relevant indicator, which is defined in Annex X, Part 1 of Part C of the Directive as the average over three years of the sum of net income.

3. Own Funds

The own funds of Veles International Limited as at 31.12.2008 were US\$1.474.764 as shown below:

Original Own Funds (Tier 1)	US\$
Share Capital	1.415.218
Reserves	59.546
Total Tier 1	1.474.764
Total own funds	1.474.764

3.1. Original Own Funds

Share Capital

On incorporation the Company issued 10.000 ordinary shares of CYP£1 each. The exchange rate used for translation was US\$2.122 resulting in US\$21.224. On 5 October 2006 the Board of Directors decided to increase the share capital by issuing additional 150.000 ordinary shares of CYP£1 each. The new exchange rate used for translation was US\$2.208 resulting in a value of US\$331.200.

On 28 March 2007 the Board of Directors decided to increase the issued share capital by issuing additional 140.000 ordinary shares of CYP£1 (US\$2.3015) each and further 300.000 ordinary shares of CYP£1 (US\$2.4645) each on 29 October 2007. Total issued share capital increase amounted to US\$1.061.560.

With the introduction of the Euro as the official currency of the Republic of Cyprus as from 1 January 2008, the nominal value of the Company's share capital has changed from Cyprus pounds to Euro based on the definite fixing of the exchange rate of €1 = C£0.585274.

As at 31.12.2008 the share capital of the Company comprised of 600.000 shares with a nominal value of EUR 1.71 each for the total amount of US\$ 1.415.218.

4. Minimum Required Own Funds for Credit, Market and Operational Risk

4.1. Company's Approach to Assessing the Adequacy of its Internal Capital

Different approaches based on the different categories of risks are used to assess the adequacy of the Company's internal capital to support current and future activities. These approaches are described below.

Standardised Approach for Credit Risk

The necessary mechanism for the capital calculation in accordance with the Standardised Approach is implemented in accordance with the Directive, paragraphs 2-7 of Chapter 1 of Part C.

The following table shows 8% of the risk-weighted Company's exposure amounts as at 31.12.2008 for each of the exposure classes specified in paragraph 3 of Chapter 1 of Part C of the Directive.

	US\$
Institutions	38.114
Corporates	20.261
Other items	10.392
	<u>68.767</u>

Minimum Capital Requirements for Trading Book Activities

The minimum capital requirement calculated in accordance with paragraph 11, points (b) and (c), Chapter 3 of Part A of the Directive for trading book activities is as follows:

	US\$
Traded debt instruments	55.200
Equity shares	45.238
Foreign Exchange	29.393
	<u>129.831</u>

Minimum Capital Requirements in Relation to Operational Risk

The minimum capital requirement in relation to operational risk calculated in accordance with the Standardised Approach (Part C, Chapter 5, paragraphs 27 to 29 of the Directive) amounts to US\$175.169.

Other Own Funds Requirements

The capital requirement in relation to other own funds requirements calculated in accordance with the Part D, Chapter 2, paragraph 6(b) of the Directive amounts to US\$339.970.

5. Counterparty Credit Risk

As at 31 December 2008, the Company did not have securities or commodities lending or borrowing transactions, long settlement transactions or margin lending transactions outstanding.

6. Company's Exposure to Credit Risk and Dilution Risk

Past due accounts receivable are defined as all accounts receivable where the counterparty has failed to make a payment when it is contractually due. At each balance sheet date the Company assesses whether there is any objective evidence that accounts receivable (/debts) are impaired. A debt is impaired if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the liability (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the debt or the group of debts, that can be reliably estimated.

6.1. Total Amount of the Exposures

Exposures by different type of exposure classes as at 31 December 2008

Type	Institutions US\$	Corporates US\$	Other items US\$	Total US\$
Cash and cash equivalents	2.109.590	-	-	2.109.590
Trade receivables	79.472	253.259	-	332.731
Other receivables	-	-	130.382	130.382
Prepayments	-	-	41.303	41.303
Amounts due from related parties	193.073	-	-	193.073
Total	<u>2.382.135</u>	<u>253.259</u>	<u>171.685</u>	<u>2.807.079</u>

6.2. Geographic Distribution of the Exposures

Exposures by geographic area as at 31 December 2008

Country	Institutions US\$	Corporates US\$	Other items US\$	Total US\$
Cyprus	1.952.006	253.259	171.685	2.376.950
Latvia	30.330	-	-	30.330
Russia	332.011	-	-	332.011
Ukraine	67.788	-	-	67.788
Total	<u>2.382.135</u>	<u>253.259</u>	<u>171.685</u>	<u>2.807.079</u>

6.3. Distribution of the Exposures by Industry or Counterparty Type

Exposures by industry or counterparty type as at 31 December 2008

Industry / Counterparty type	Institutions US\$	Corporates US\$	Other items US\$	Total US\$
Financial institutions	2.382.135	-	-	2.382.135
Others	-	253.259	171.685	424.944
Total	<u>272.545</u>	<u>253.259</u>	<u>171.685</u>	<u>2.807.079</u>

6.4. Residual Maturity Breakdown of the Exposures

Exposures by the residual maturity as at 31 December 2008

	Institutions US\$	Corporates US\$	Other items US\$	Total US\$
Less than 1 year	2.382.135	-	-	2.382.135
1 to 5 years	-	253.259	171.685	424.944
Total	<u>272.545</u>	<u>253.259</u>	<u>171.685</u>	<u>2.807.079</u>

6.5. Impaired Exposures and Past Due Exposures

As at 31 December 2008, the Company did not have any impaired exposures or past due exposures.

7. The Standardised Approach

7.1. Exposure Classes for which External Credit Assessment Institutions ('ECAI') or Export Credit Agencies ('ECA') are Used

The Company uses external ratings from Standard&Poor's. These ratings are used for all relevant exposure classes, which are the following:

- Claims or contingent claims on institutions
- Claims or contingent claims on corporates (it should be noted that most corporates are unrated)
- Short-term claims on institutions and corporates

7.2. Transfer of Credit Assessments onto Items not Included in the Trading Book

The exposures are classified into the above exposure classes, and are then ranked into respective credit quality steps, that determine the risk-weight to be used in accordance with the provisions of the Directive.

In the case of financial institutions, the credit quality step is determined, according to the rating of the country under whose supervision they operate. It should be noted that all exposures with financial institutions with original maturity of three months or less, are risk-weighted 20%, unless the counterparty is unrated and the risk-weight assigned to its country is higher.

7.3. Association of the External Rating of Each Nominated ECAI or ECA with Credit Quality Steps

The Company complies with the standard association published by CySEC, regarding the association of the external rating of each nominated ECAI or ECA with the credit quality steps prescribed in Annex VI of the Directive.

7.4. Exposure Values Associated with Credit Quality Steps

The exposure values before and after credit risk mitigation associated with each credit quality step prescribed in Annex VI of Part C of the Directive as at the 31 December 2008 were as follows:

Rating	Total exposure US\$
A+	2.082.388
BBB	332.011
BB+	30.330
CCC+	67.788
Not rated	294.562
	<hr/> 2.807.079 <hr/>

As at the year-end the Company did not employ any credit risk mitigation for its exposures, therefore, the above amounts indicate the exposures both before and after credit risk mitigation.

8. Exposures in Equities Not Included in the Trading Book

The Company did not hold any equity securities not included in the trading book as at the 31 December 2008.

9. Exposure to Interest Rate Risk on Positions Not Included in the Trading Book

Interest rate risk is the risk that the value of financial instruments will fluctuate due to changes in market interest rates. The Company's Risk Manager monitors the interest rate fluctuations on a continuous basis and acts accordingly.

Impact on Net Assets

At 31 December 2008, should interest rates have increased/(decreased) by 50 basis points (change in the risk variable is what have been considered by management as reasonably possible at 31 December 2008) with all other variables remaining constant, the increase/(decrease) in net assets attributable to equity holders for the year would amount to approximately US\$14.193 – the difference between the estimated change in interest receivable that would amount to approximately US\$14.362 and the estimated change in interest payable of approximately US\$169.

The table below summarises the increase or decrease in net assets attributable to shareholders at 31 December 2008, had the exchange rate between currency Russian Rouble and United States Dollar increased or decreased by 15% and Euro and United States Dollar – by 10% (estimated marginal percentage changes in the risk variables are taken based on the average fluctuations in according exchange rates during year 2008) considered by management as possible at the reporting date with all other variables held constant.

	US\$	Effect
Russian Rouble	168.968	Decrease / Increase
Euro	24.175	Decrease / Increase
Total	193.143	

Measuring the Interest Rate Effect

The following methodology is used to measure the interest rate effect.

The assets and liabilities in each currency are placed in time bands, according to the number of days remaining from the reporting date until their maturity. The difference between assets and liabilities in each time band, 'the gap' is then calculated. The gaps are the starting point in calculating the impact on net assets from a certain change in interest rates.